First Trust

ALTERNATIVES UPDATE

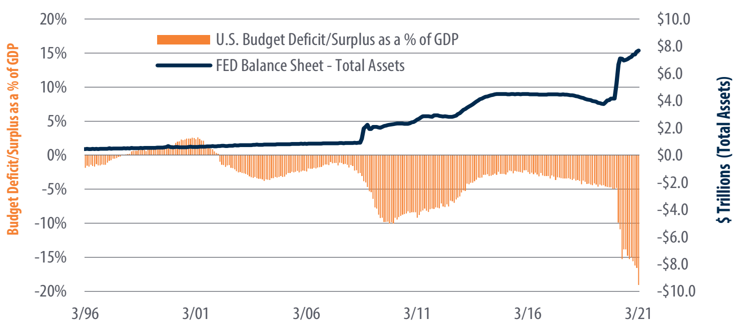
1st Quarter 2021

The Biden presidency is officially underway and the agenda they have laid out is no surprise: massive spending, massive deficits, massive tax increases, massive governmental expansion. Historically, such activity would raise investor concerns about distorted incentives, reduction in productivity and stifling of innovation. Throw conventional wisdom out the door; the stock market loves it. Fully in step with the new administration, the Federal Reserve (the "FED") has been outspoken in calling for outsized fiscal spending and Congress has delivered, as evidenced by the staggering spending deficit. Apparently the FED believes direct intervention into the capital markets and growing their $7 trillion balance sheet an additional $120 billion each month is not enough (see Figure 1).

Year-over-year CPI came in at a paltry 1.7% for February (as reported in March 2021) which seems to be a bit of a disconnect with price changes in major swaths of the economy (see Figure 2). The shortage of semiconductors is grabbing headlines, but supply disruptions are affecting many sectors of the economy. Kimberly Clark, a consumer products global giant, announced they intend to increase prices in the mid to high single digits, yet neither the FED nor the Treasury convey worry. "Transitory" seems to be the generic response to inflation concerns. It wasn't too long ago that FED Chairman Jerome Powell stated Modern Monetary Theory (MMT) is "just wrong" (2019); now he is its most recognizable practitioner. It was Treasury Secretary Janet Yellen who said that she did not see another financial crisis occurring in her lifetime (2017). It's not exactly confidence inspiring that both dismiss the notion that all the monetary and fiscal stimulus will NOT create sustained inflation. Real estate and commodity markets seem to be offering dissenting views. Returns for major asset classes were exceptionally strong in the 1st quarter of 2021. Real Estate led the way this quarter with the Dow Jones U.S. Real Estate Index up (+7.70%), followed very closely by the Bloomberg Commodity Index (+6.92%). Equity markets were all positive, the S&P 500 Index was up (+6.17%), the MSCI EAFE Index was up (+3.48%) and the MSCI Emerging Market Index was up (+2.29%). Long-dated U.S. Treasuries fell (-14.20%), while high-yield bonds eeked out a tiny gain of (+0.57%). The U.S. Dollar Index reversed the trend from the prior quarter rising (+3.66%) (see Figure 3).

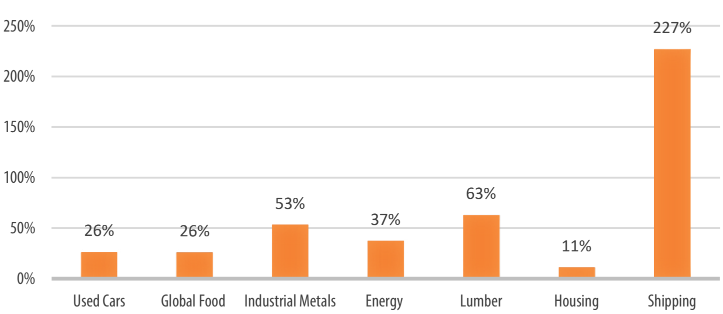
Alternative Investments ("alternatives") had a solid quarter with positive returns in every category. Higher correlation/higher beta strategies, on average fared better (see Figure 4). Distressed/Restructuring debt was the best performing category (+8.76%). Other significant gainers were event driven (+8.21%), real estate (+7.70%), hedged equities (+7.36%), and commodities (+6.92%). Equity market neutral (+3.47%), managed futures (+2.52%) and volatility arbitrage (2.30%) all lagged the wider alternative category but still had decent returns. In a strong showing for alternatives, half of the categories outpaced the S&P 500 Index (see Figure 5) despite the index having a rather strong quarter itself.

Figure 1 Federal Reserve Balance Sheet



Source: Bloomberg, Data from 3/31/96 - 3/31/21.

Figure 2 Year-Over-Year Price Changes



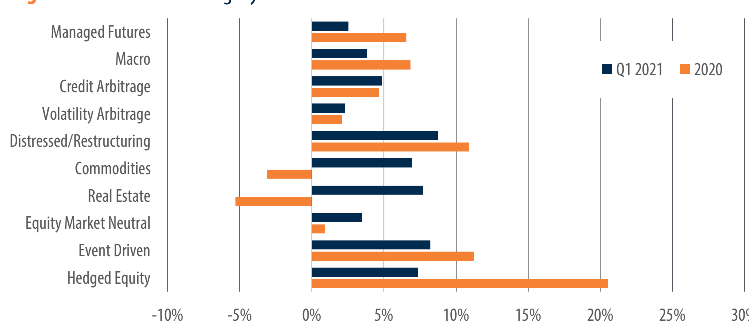
Source: Bloomberg, 3/31/21. Housing is as of 1/31/21 (latest data available).

Figure 3 Asset Class Returns

	Q1 2021	2020
U.S. Equities	6.17%	18.40%
International Developed	3.48%	7.82%
Emerging Markets	2.29%	18.31%
U.S. Treasury	-14.20%	18.06%
Real Estate	7.70%	-5.29%
Commodities	6.92%	-3.12%
High Yield Bonds	0.57%	5.87%
U.S. Aggregate Bonds	-3.37%	7.51%
Bitcoin	103.34%	305.07%
U.S. Dollar	3.66%	-6.69%

Source: Bloomberg, 3/31/21.

Figure 4 Alternative Category Performance



Source: Bloomberg, 3/31/21.

References to specific companies or securities should not be construed as a recommendation to buy or sell any such security, nor should they be assumed profitable.

All charts shown herein are for illustrative purposes only and not indicative of any investment. The performance illustrations exclude the effects of taxes and brokerage commissions or other expenses incurred when investing. ***Past performance is not indicative of future results*** *and there can be no assurance past trends will continue in the future. An investor cannot invest directly in an index. See last page for definitions of asset class indexes and other terms discussed herein.*

Traditionally, managed futures and macro strategies are viewed as having lower correlations to equities because they are generally diversified across a variety of markets and often employ shorting as part of their approach. Strategies that had higher 2-year correlations to U.S. equities (greater than 0.60), on average, significantly outperformed those strategies that had a lower correlation with U.S. equities. The spread was 302 basis points ("bps") (see Figure 6). Two of three real assets had sizeable positive returns (see Figure 7). Real estate was up (+7.70%). While existing home sales drifted off from recent highs, home prices as measured by the S&P CoreLogic Case-Shiller Index hit another record high. That index now stands 28% higher than its housing bubble peek in 2006. Commodities notched significant gains (+6.92%) which becomes even more impressive when one considers the fact that the U.S. Dollar rose over 3% during the quarter. Certain inflation hedging assets seem to be catching investor's eyes. Gold fell (-10.04%) as nominal yields rose and real yields rose even faster. Gold may also have suffered from the unwind of the safety trade and the consequent shift to more risky assets.

Managed futures, commodities, and macro strategies have historically shown low correlation and beta to stocks and bonds over the course of a market cycle; thus, they may serve as potentially strong portfolio diversifiers. Strategies such as credit arbitrage, event driven, hedged equity, et al., which have historically had higher correlations with equities and bonds, may provide attractive risk/return profiles through lower volatility. These characteristics may allow investors to broaden their investment choices and create more efficient portfolios.

Returns for "Risk On" assets (+1.45% average return) considerably outperformed the returns for "Risk Off" assets (-9.34% average return). The S&P 500 Index had the best return in the first quarter and U.S. Treasuries the worst return (see Figure 8). Focusing on non-currencies, equities and high- yield bonds outperformed gold and long dated (20 yr. +) U.S. Treasuries by an average of 1549 bps. Alternatives have historically provided significant diversification benefits when paired with a portfolio of traditional assets, in addition to both competitive absolute returns and attractive risk-adjusted returns. Please Note: Alternative investments may employ complex strategies, have unique investment, and risk characteristics that may not be suitable for all investors.

Figure 5 Excess Return vs. S&P 500 Index

Category	Q1 2021
Distressed/Restructuring	2.58%
Event Driven	2.03%
Real Estate	1.52%
Hedged Equity	1.18%
Commodities	0.75%
Credit Arbitrage	-1.31%
Macro	-2.34%
Equity Market Neutral	-2.71%
Managed Futures	-3.65%
Volatility Arbitrage	-3.88%

Source: Bloomberg, 3/31/21.

Figure 6 Correlations (2yr) & Returns

	S&P 500 Index	Q1 2021
Hedged Equity	0.93	7.36%
Event Driven	0.84	8.21%
Real Estate	0.82	7.70%
Commodities	0.71	6.92%
Distressed/Restructuring	0.70	8.76%
Credit Arbitrage	0.69	4.87%
Equity Market Neutral	0.81	3.47%
Volatility Arbitrage	0.67	2.30%
Managed Futures	0.32	2.52%
Macro	0.47	3.83%
Lower Correlation Avg TR (<=0.60)		3.18%
Higher Correlation Avg TR (>0.60)		6.20%

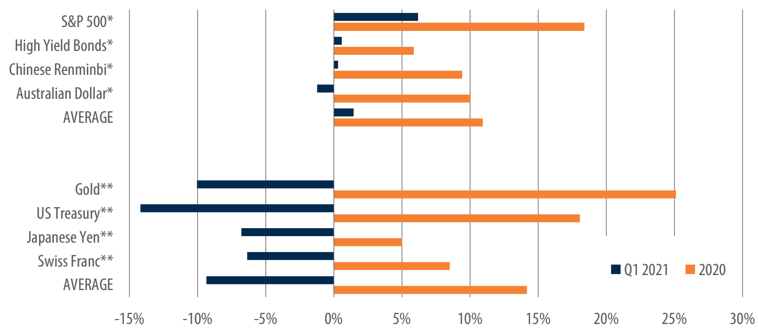
Source: Bloomberg, 3/31/21. Monthly returns over 24 months.

Figure 7 Real Assets

	Q1 2021	2020
Real Estate	7.70%	-5.29%
Commodities	6.92%	-3.12%
Gold	-10.04%	25.12%
Average	1.53%	5.57%

Source: Bloomberg, 3/31/21.

Figure 8 Risk On vs. Risk Off Assets



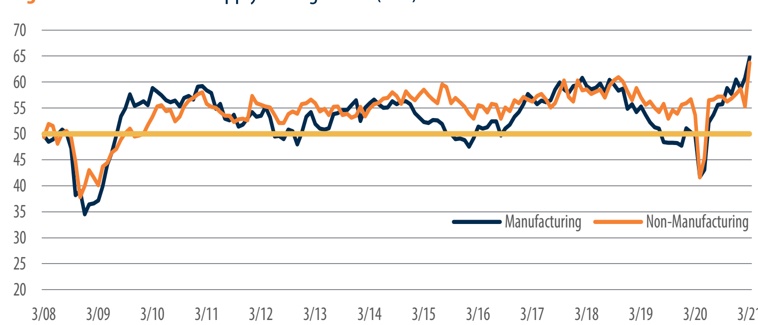
Source: Bloomberg, 3/31/21. *Considered to be "Risk On" asset class. **Considered to be "Risk Off" asset class.

Figure 9 Cryptocurrency Returns

	Q1 2021	2020
BB Galaxy Crypto Index	118.32%	276.70%
Bitcoin	103.34%	305.07%
Ethereum	162.47%	475.51%
Ripple	151.04%	18.00%
Litecoin	57.68%	200.69%

Source: Bloomberg, 3/31/21.

Figure 10 Institute for Supply Management (ISM) Data



Source: Bloomberg, Data from 3/31/08 - 3/31/21. Seasonally adjusted (SA). Numbers above 50% indicate an expansion, below 50% indicates a contraction.

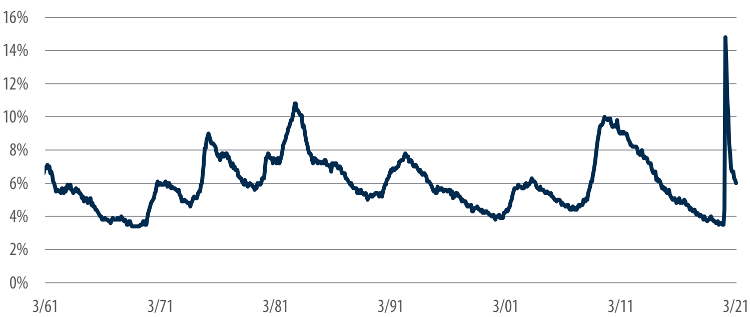
Returns in the cryptocurrencies sector once again breached triple digits in the first quarter (see Figure 9). Bitcoin, the flagship cryptocurrency, was up 103.34%, while the wider universe of cryptocurrencies, as measured by the Bloomberg Galaxy Crypto Index, rose 118.32%. Ethereum soared 162.47%, while Litecoin was up 57.68%. XRP (the Ripple digital asset), which dramatically lagged the cryptocurrency sector in 2020 due to the Securities and Exchange Commission (SEC) pursuing action against Ripple Labs Inc. (the software company behind the issuance of XRP) and two of its executives was up 151.04%. A series of procedural wins and a growing sentiment that XRP will be found to fall outside the jurisdiction of the SEC likely contributed to the strong advance.

Economic data continued to trend upwards and point towards a significantly improving economy. The ISM manufacturing indicator ended the quarter at 64.7, its highest reading since 1983. The ISM non-manufacturing indicator services rose sharply to 63.7, its highest level ever. For both indicators, levels below 50 represent a contraction (see Figure 10). Unemployment, as measured by the U-3 seasonally adjusted rate, continued to trend downward, falling to 6.0%, though the labor participation rates, and a high level of underemployment remain concerns (see Figure 11).

Sentiment, as measured by the University of Michigan Consumer Sentiment Index, moved higher to reach 84.9. Another sentiment indicator, the Conference Board Consumer Confidence Index, soared during the quarter to 109.7 (see Figure 12). The year-over-year Consumer Price Index (CPI) jumped solidly and ended the quarter at 2.6% (see Figure 13), the highest reading since 2018. The FED has been striving for inflation and the data is pointing towards that happening.

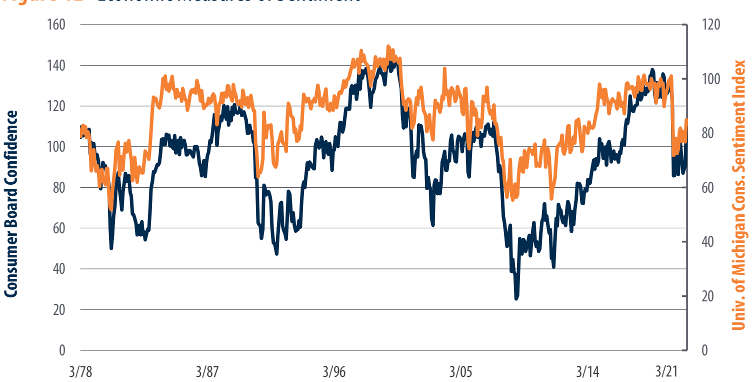
Baa/BBB rated corporate bonds marginally outperformed 10-year U.S. Treasuries as we believe investors sought out risk while shedding high-quality duration and safety. Fixed income investors appear to be concerned about the inflationary pressures building because of actions by the FED and Congress. The Baa/BBB over 10-year U.S. Treasuries yields narrowed 17 bps over the quarter (see Figure 14). This spread ended the quarter at the 35th percentile (see Figure 15). The spread between below investment grade corporate bonds (B/CA rated) and BBB rated corporate bonds (investment grade) fell by over 68 bps during the quarter to a scant 117 bps, representing the 12th percentile. While BBB yields rose 66 bps, B/CA rated narrowed 3 bps reflecting a modest desire by investors to move out on the risk spectrum (see Figure 16).

Figure 11 U.S. Unemployment Rate (U-3)



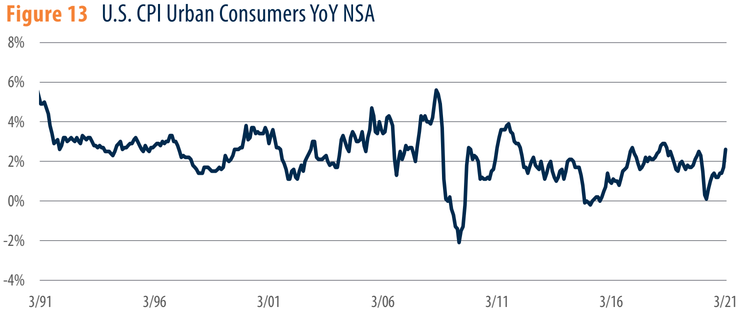
Source: Bloomberg, Data from 3/31/61 - 3/31/21. Seasonally adjusted (SA).

Figure 12 Economic Measures of Sentiment



Source: Bloomberg, 3/31/78 - 3/31/21.

Figure 13 U.S. CPI Urban Consumers YoY NSA



Source: Bloomberg, 1/31/91 - 3/31/21, not seasonally adjusted (NSA).

Figure 14 BAA Corp Credit Spread over 10-Yr U.S. Treasury (%)

Source: Bloomberg, 3/31/91 - 3/31/21.

Figure 15 Credit Spread Percentile Rank (%)

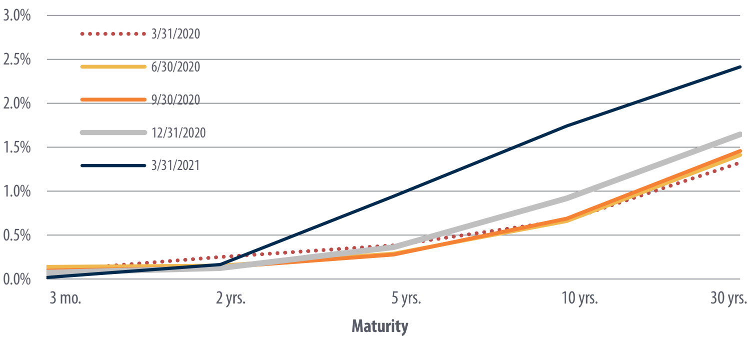
Source: Bloomberg, 3/31/91 - 3/31/21.

Figure 16 B/CA Credit Spread over BBB (US Corp) (%)

Source: Bloomberg, Data from 1/31/07 - 3/31/21.

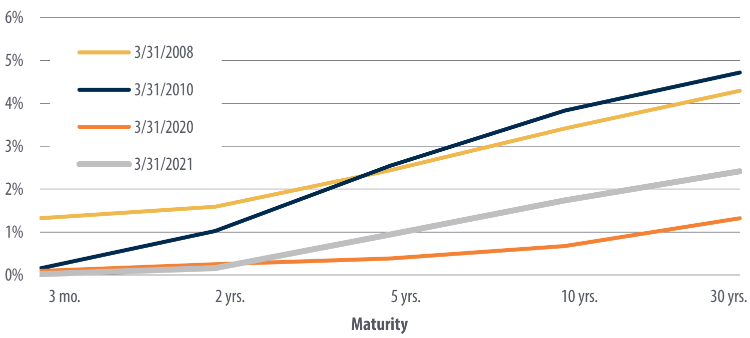
The FED has maintained a very consistent message: there is a need for both monetary and fiscal stimulus of historic proportions to continue to ensure a stable recovery. Asset purchases would not be tapered, they could in fact be accelerated if necessary. The zero-interest rate policy (ZIRP) would be left intact for the foreseeable future, asset bubbles were not of much concern, inflation was not an issue. While the continued flood of liquidity and never ending ZIRP was cheered by equities, the flow of money into commodities and out of long-dated U.S. Treasuries hints that investors aren't quiet buying the glib attitude towards inflation. In the first quarter, U.S. Treasury 10-year yields rose 83 bps to 1.74% at quarter end, while 30-year yields rose 77 bps to a yield of 2.41%. The yield spread between 30-year to 10-year U.S. Treasuries narrowed 6 bps to a spread of 67 bps. The U.S. Treasury yield curve steepened as the yield spread between 30 year Treasuries and T-bills (3 mo. maturity) widened out and ended the quarter at 240 bps (see Figure 17 and Figure 18). With CPI jumping significantly, real yields (nominal yields-CPI) ended negative across all maturities despite a very large move up in nominal yields on the long end of the curve (See Figure 19).

Figure 17 U.S. Treasury Yield Curve



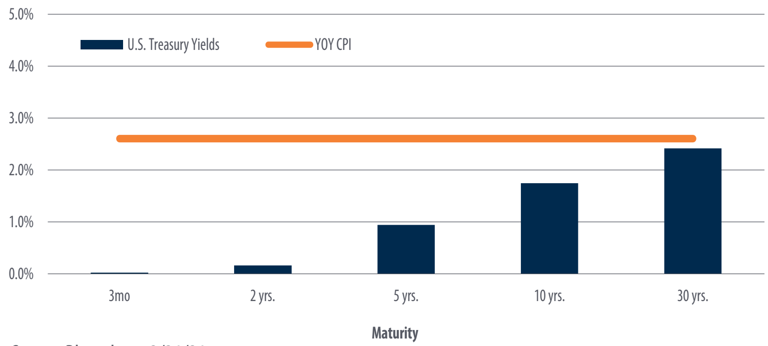
Source: Bloomberg, 3/31/21.

Figure 18 U.S. Treasury Yield Curve



Source: Bloomberg, 3/31/21.

Figure 19 U.S. Treasury Yield Curve and CPI



Source: Bloomberg, 3/31/21.

Definitions

10-Yr Treasury: Yield of U.S. Treasury securities maturing in approximately 10 years.

Aggregate Bonds: The Bloomberg Barclays US Aggregate Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

BAA Corp: Moody's Bond Indices Corporate BAA. Moody's Long-Term Corporate Bond Yield Averages are derived from pricing data on a regularly replenished population of corporate bonds in the U.S. market, each with current outstanding over $100 million. The bonds have maturities as close as possible to 30 years; they are dropped from the list if their remaining life falls below 20 years, if they are susceptible to redemption, or if their ratings change. All yields are yield-to- maturity calculated on a semi-annual basis.

Beta: A measure of price variability relative to the market.

Bitcoin: A digital currency using encryption techniques created for use in peer-to-peer online transactions Introduced in 2008 by a person or group using the name Satoshi Nakamoto.

Bloomberg Barclay US Corp B-Ca Capped Index: The Bloomberg Barclays index measures the performance of the taxable B1 – Ca rated range of the fixed-rate U.S. dollar-denominated corporate bond market. The index is market capitalization weighted and caps individual issuers at 3% of the total market value.

Bloomberg Galaxy Crypto Index (BGCI): The BGCI is designed to measure the performance of the largest cryptocurrencies traded in USD.

Commodities: The Bloomberg Commodity Index is made up of exchange-traded futures on physical commodities and represents 20 commodities, which are weighted to account for economic significance and market liquidity.

Consumer Price Index (CPI): A measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them. Changes in the CPI are used to assess price changes associated with the cost of living.

Correlation: A statistical measure that quantifies the extent to which two or more data series fluctuate together. Values run from -1.0 to +1.0.

Credit Arbitrage: Hedge Fund Research HFRI Event-Driven Credit Arbitrage Index. Credit Arbitrage strategies employ an investment process designed to isolate attractive opportunities in corporate fixed-income securities; these include both senior and subordinated claims as well as bank debt and other outstanding obligations, structuring positions with little of no broad credit market exposure. These may also contain a limited exposure to government, sovereign, equity, convertible or other obligations but the focus of the strategy is primarily on fixed corporate obligations and other securities are held as component of positions within these structures.

Cryptocurrency is a digital or virtual currency that is secured by cryptography, which makes it nearly impossible to counterfeit or double-spend.

Distressed/Restructuring: Hedge Fund Research HFRI Event-Driven Distressed/Restructuring Total Index. Distressed/ Restructuring strategies employ an investment process focused on corporate fixed-income instruments, primarily on corporate credit instruments of companies trading at significant discounts to their value at issuance or obliged (par value) at maturity as a result of either formal bankruptcy proceeding or financial market perception of near term proceedings.

Emerging Markets: The MSCI Emerging Markets Index captures large and mid cap representation across Emerging Markets (EM) countries. The index covers 85% of the free float-adjusted market capitalization in each country.

Equity Market Neutral: Hedge Fund Research HFRI Equity Hedge Equity Market Neutral Index. Equity Market Neutral strategies employ sophisticated quantitative techniques of analyzing price data to ascertain information about future price movement and relationships between securities, select securities for purchase and sale. Equity Market Neutral Strategies typically maintain characteristic net equity market exposure no greater than 10% long or short.

Ethereum: Ethereum is a platform that offers programming code of any decentralized application. It has been linked to payment style transactions. Ether is the cryptocurrency issued through open-source code executed on thousands of nodes.

Event Driven: Hedge Fund Research HFRI Event-Driven (Total) Index. Investment Managers who maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments.

Gold: The return of the gold spot price as quoted as U.S. dollars per Troy Ounce.

Hedged Equity: Hedge Fund Research HFRI Equity Hedge (Total) Index. Investment Managers who maintain positions both long (positions that are owned) and short (positions that are owed) in primarily equity and equity derivative securities. Hedged Equity managers would typically maintain at least 50%, and may in some cases be substantially entirely invested in equities, both long and short.

High-Yield Bonds: The Bloomberg Barclays US High Yield Very Liquid Index (VLI) is a component of the US Corporate High Yield Index that is designed to track a more liquid component of the USD-denominated, high yield, fixed-rate corporate bond market. The US High Yield VLI uses the same eligibility criteria as the US Corporate High Yield Index, but includes only the three largest bonds from each issuer that have a min amount outstanding of USD500mn and less than five years from issue date.

International Developed: The MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. The index is a free-float weighted equity index.

Litecoin: A peer-to-peer cryptocurrency and open source software project similar to Bitcoin, Litecoin uses blockchain technology to process transactions. Litecoin, referred to as an alt-coin can process blocks faster than Bitcoin, uses a different mining algorithm and has larger supply.

Long/Short: "Long" and "short" are investment terms used to describe ownership of securities. To buy securities is to "go long." The opposite of going long is "selling short." Short selling is an advanced trading strategy that involves selling a borrowed security. Short sellers make a profit if the price of the security goes down and they are able to buy the security at a lower amount than the price at which they sold the security short. A put gives the holder the right to sell the underlying asset at a specified price on or before expiration.

Macro: Hedge Fund Research HFRI Macro (Total) Index. Investment Managers which trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed-income, hard currency and commodity markets.

Managed Futures: BarclayHedge US Managed Futures Industry Top 50 (BTop 50) Index. The Index seeks to replicate the overall composition of the managed futures industry with regard to trading style and overall market exposure.

Modern Monetary Theory (MMT): MMT describes currency as a public monopoly and unemployment as evidence that a currency monopolist is overly restricting the supply of the financial assets needed to pay taxes and satisfy savings desires.

Risk-On and Risk-Off is an investment setting in which price behavior responds to and is driven by changes in investor risk tolerance. Risk-on risk-off refers to changes in investment activity in response to global economic patterns.

Real Estate: The Dow Jones US Real Estate Index is designed to track the performance of real estate investment trusts (REITs) & other companies that invest directly or indirectly in real estate through development, management or ownership, including property agencies.

Ripple: Known as XRP, Ripple is a cryptocurrency that can be used on open source distributed ledger created by the company Ripple. It is built upon the principles of blockchain as an on-demand option for faster cross border payments.

S&P CoreLogic Case-Shiller U.S. National Home Price Index: tracks the value of single-family housing within the United States. The index is a composite of single-family home price indices for the nine U.S. Census divisions.

U.S. Equities: The S&P 500 Index. An unmanaged index of 500 stocks (currently 505) used to measure large-cap U.S. stock market performance.

U.S. 30-Yr Treasury Yield: Yield of U.S. Treasury securities maturing in approximately 30 years.

U.S. Dollar: The U.S. Dollar Index (USDX) indicates the general international value of the U.S. dollar. The USDX does this by averaging the exchange rates between the USD and major world currencies. The ICE US computes this by using the rates supplied by some 500 banks.

U.S. Treasury: The ICE U.S. Treasury 20+ Years Bond Index is part of a series of indices intended to assess U.S. Treasury issued debt. Only U.S. dollar denominated, fixed-rate securities with minimum term to maturity greater than twenty years are included.

U.S. Treasury Bill (T-Bill): is a short-term U.S. government debt obligation backed by the Treasury Department with a maturity of one year or less.

Volatility Arbitrage: Hedge Fund Research HFRI Relative Value Volatility Index. Volatility strategies trade volatility as an asset class, employing arbitrage, directional, market neutral or a mix of types of strategies, and include exposures which can be long, short, neutral or variable to the direction of implied volatility, and can include both listed and unlisted instruments. Directional volatility strategies maintain exposure to the direction of implied volatility of a particular asset or, more generally, to the trend of implied volatility in broader asset classes. Arbitrage strategies employ an investment process designed to isolate opportunities between the price of multiple options or instruments. Volatility arbitrage positions typically maintain characteristic sensitivities to levels of implied and realized volatility, levels of interest rates and the valuation of the issuer's equity, among other more general market and idiosyncratic sensitivities.

Yield Spread: The difference in yields on differing debt instruments of varying maturities, credit ratings, issuer, or risk level.

ZIRP: A zero interest rate policy (ZIRP) is when a central bank sets its target short-term interest rate at or close to 0%.